

SHAREHOLDER DEADLOCKS: COMPLICATIONS FOR DIRECTORS

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The previous chapter, “Boardroom Dramas: Shareholders in Deadlock” underscored the primary duty of directors to fulfil their fiduciary duties to the company honestly, reasonably, and diligently over any other duty to opposing groups of shareholders.

In this chapter, I would like to cast the spotlight on the complications for directors arising from shareholder deadlock situations. There are three common complications:

- when a director is also a shareholder;
- when a director is a nominee of a principal shareholder; and
- when the company is insolvent.

THE DIRECTOR AS SHAREHOLDER

When a director is also a shareholder of the company or its related company, must he still exercise his powers in the company's interests? This quandary arises because a shareholder, unlike a director, does not owe fiduciary duties to the company and can generally vote as a shareholder in any manner he wishes.

At all times, the director must be careful not to confuse his roles as director and shareholder. When voting as a shareholder in a general meeting, he can generally act in his own interests and need not justify his decisions.

However, as a director, he must first disclose the nature and extent of his shareholdings to the company in accordance with the Companies Act – if it is not already reflected on the company's register.

Additionally, when acting or exercising his powers as a director or voting as director in a directors' meeting, he must act in the best interests of the company without being influenced by his personal interests as a shareholder. He must do so even if doing so is contrary to his own personal interests as a shareholder. This is often a difficult balance to maintain. If in doubt, a prudent director should abstain from voting at directors' meetings and should always disclose his conflict of interest to the board of directors in a directors' meeting.

THE NOMINEE DIRECTOR

Some directors are appointed by a major shareholder, a lender or an investor to represent its interests on the board. The nominee director then faces a dilemma in a shareholder deadlock since the

appointer would expect him, as nominee, to favour the interests of his appointor in a deadlock situation.

In such cases, the nominee director must remain impartial even though he may incur the displeasure of his appointor. The law is clear that a nominee director is still subject to the same fiduciary duties to act in the best interests of the company. He has to avoid a position where the company's interests conflict with a third party interest for whom he acts.

In short, a director cannot put his appointor's interests before the company's interests. If necessary, he should abstain from participating in discussions or decisions on the specific issue.

Additionally, the Companies Act prohibits a director from disclosing any information obtained by virtue of his position as a nominee director, to gain advantage for his appointor, or to cause disadvantage to the company.

If a director wishes to disclose information to his appointor, there are specific conditions in the Companies Act that must be fulfilled, such as obtaining authorisation from the board and ensuring that the disclosure is not likely to prejudice the company. Nominee directors should tread carefully as any breaches could result in criminal and/or civil sanctions.

THE INSOLVENT COMPANY

When the company is solvent, directors owe their duties to the company and not its creditors. However, if the company becomes insolvent or potentially insolvent during the course of the shareholder deadlock, fiduciary duties take on an added dimension.

First, directors are now obliged to consider the interests of the company's present and future creditors as the dominant factor in determining the best interests of the company.

For example, directors cannot dispose of, or exploit, assets improperly to the prejudice of creditors since creditors look to the company for payment. Secondly, directors may be personally liable for payment of any or all of the company's debts.

They may also be criminally liable under the Companies Act if they carry on business to defraud creditors, or cause the company to contract debts without any reasonable or probable expectation of repayment.

In this context, directors cannot make decisions at the expense of creditors, even if the decision may favour shareholders' interests.

The challenge facing all directors is to navigate through tricky issues that may arise from a shareholder deadlock, and to avoid being in breach of their fiduciary duties.

Directors must always be aware of their rights and obligations under the law to enable them to act appropriately. At the end of the decision-making day, directors should, at all times, act methodically, record valid reasons for their business decisions, and take legal advice in cases of doubt. ■